27 February 2024

HARDMAN&CO.

Diversified Financial Services

Source: LSEG

Market data

EPIC/TKR	**RECI**
Price (p)	**120.5**
12m high (p)	143.C
12m low (p)	109.5
Shares (m, Exc. Treasury)	227.C
Mkt cap (£m)	273.5
NAV p/sh (Jan'24, p)	145.5
Disc. to NAV (%)	-17
Div. yield (FY'23)	10.0%
Country/Ccy of listing	UK/GBF
Market	Premium equity closed-ended inv. funds

Description

Real Estate Credit Investments (RECI) is a closed-ended investment company that originates and invests in real estate debt secured by commercial or residential properties in the United Kingdom and Western Europe.

Company information

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NEDs	Susie Farnon, John Hallam, Colleen McHugh
Inv. Mgr.	Cheyne Capital
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Key shareholders (Mar'23)

Close Bros.	9.18%
Bank Leumi	7.87%
Hargreaves Lansdown AM	6.30%
Canaccord Genuity	5.81%
Tilney Smith and Williamson	5.79%
FIL	5.18%

Diary

Mid-Mar	Feb NAV

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REAL ESTATE CREDIT INVESTMENTS

French and German exposures in perspective

We last reviewed RECI's operations in France, 25% of the latest portfolio, in our note, *Vive la difference,* published 15 February 2022. The core approach is unchanged, but, following the *December 2023 factsheet* report of an unrealised hit of 1.6p to the NAV from a prime Grade A Paris office exposure, we thought we would review them again. Also, with the *November Factsheet* reporting a 1.1p NAV hit from a legacy mezzanine position exposed to a Berlin asset, we have considered the *de minimis* German exposure. While the unrealised losses were unexpected, we show how conservative RECI's accounting has been and the portfolio resilience.

- **Conservative approach:** Our note, *Marks taken in uncertainty, released thereafter*, highlighted RECI's record of taking MTM hits in periods of uncertainty, only to be followed by subsequent releases. This conservative accounting is on top of robust risk assessment, monitoring, problem account management and portfolio diversification.
- ***January 2024 factsheet*:** Underlying NAV rose 1.3p, due to recurring interest income (1.1p). Cash was £23m, and gross leverage £62m. The book has 34 positions (28 loans, gross drawn value £394m, and 6 bonds, fair value £8m – down from 26 and £90m, respectively, at end-March). The weighted average LTV is 60.3%, and the yield is 10.3%.
- **Valuation:** In the five-year, pre-pandemic era, on average, RECI traded at a premium to NAV. In periods of market uncertainty, it has traded at a discount. It now trades at a 17% discount, a level not seen since late 2020. RECI paid its annualised 12p dividend in 2022, which generated a yield of 10% – expected to be covered by interest alone.
- **Risks:** Credit cycle and individual loan risk are intrinsic. All security values are currently under pressure. We believe RECI has appropriate policies to reduce the probability of default and has a good track record in choosing borrowers. Some assets are illiquid. Much of the book is development loans.
- **Investment summary:** RECI generates an above-average dividend yield from well-managed credit assets. Income from its positions covers the dividends. Sentiment to market-wide credit risk is difficult currently, but RECI's strong liquidity and debt restructuring expertise provide extra reassurance. Where needed, to date, borrowers have injected further equity into deals.

Financial summary and valuation

Year-end Mar (£m)	2022	2023	2024E	2025E
Interest income	27.0	31.9	38.0	42.2
Operating income	32.4	30.7	38.0	47.2
Management fee	(4.4)	(4.3)	(4.2)	(4.2)
Performance fee	-	-	-	-
Operating expenses	(5.8)	(6.1)	(6.2)	(6.3)
Total comp. income	24.6	20.6	26.8	35.9
EPS (p)	10.7	9.0	11.7	13.8
NAV per share (p)	150.0	146.9	146.8	149.7
S/P prem./disc. (-) to NAV*	0.4%	-9.1%	-18.0%	-19.6%
Debt to equity	29%	24%	18%	8%
Dividend (p)	12.0	12.0	12.0	12.0
Dividend yield	10.0%	10.0%	10.0%	10.0%

**2022-23 share price actual, 2024-25 forecast NAV to current share price*
Source: Hardman & Co Research

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French exposures

In our note, *Vive la difference*, we reviewed Cheyne's history in France, RECI's exposures at the time (February 2022), its robust experience throughout COVID-19 and how Cheyne had supported those accounts getting into difficulties, some case studies and a detailed commentary on the French property market.

Why RECI is in France

In our note, we also highlighted that, through investments in French property debt, RECI's investors benefit from:

Geographical diversification – important for risk management, COVID-19 restrictions and interest rate exposure

- Most obviously, there is geographical diversification. This has an immediate benefit in terms of concentration of credit exposure – so, for example, there is not a concentration on one region for hotels. It also gave diversification to exposure to COVID-19-related government restrictions and, looking forward, it will give diversification to interest rate trends. We have, in other notes, emphasised why RECI should not be harmed by raised rates, and its geographical diversity is one factor in this.

- The diversification is also of benefit to the macroeconomic effects of the recent global turbulence on recipients of RECI funds or their asset-occupiers. Naturally, in an inter-connected world, there are limits to the effectiveness of any diversification and one factor in common between UK and French real estate is the low level of investment flows and depressed turnover of assets in the secondary market. The post-COVID-19 effects on office occupancy trends are also similar between the UK and France. An important overriding factor is the resilience of the French economy compared with many other European jurisdictions.

Sector diversification

- As we detailed in the table on page 3 of the French report, the sector mix in France is different from the portfolio as a whole.

New growth options

- Growing the trust would see economies of scale, with the central costs spread over a larger business. At present, there is plenty of UK growth available to the trust. The constraints have been its capital structure, the shares trading at a discount to NAV through the pandemic, and the board not willing to dilute investors' returns by issuing shares at this level. Looking forward, there may come a time when UK growth opportunities are insufficient; and, with the French business, Cheyne, and so RECI, could have growth options that would not be available otherwise.

Investment return profile

- In France, Cheyne is competing primarily on the structuring of deals, and so is using intellectual capital, rather than taking incremental economic returns. Management believes that the outlook for French lending is more stable than, say, in the UK, with lower downside risk reflected in lower returns. RECI notes repeatedly the divergence of availability of competing bank lending capital on a country-by-country basis. While the nominal IRRs are expected to be lower to reflect this lower downside volatility, on a risk-adjusted basis, the returns are expected to be similar. France thus offers investors a different, but diversified, return profile.

RECI exposures to France

There are eight French exposures in total, split across hotels, office, logistics and co-living. Within RECI's top 10 exposure, as at end-January 2024, there were three based in France. These positions account for 19% of RECI's total NAV, within the

French total of 25%. A 3.1% exposure outside the top 10 is to a Paris prime site, which we review in detail below.

French top 10 positions, by commitment

Asset type	Commitment (£m)	As a % NAV	Entry LTV (%)	Loan type	Sector	County
Refurbishment and extension of a freehold office building in Saint Ouen, Paris	30.9	9	58	Senior	Office	Value add/Transition
Income-producing residential developer	20.6	6	36	Senior	Residential	Development
French hotels in Nice and Paris. Expected completion in 3Q'24	19.9	4	80	Senior	Hotel	Development

Source: RECI October Factsheet, Hardman & Co Research

Colisée – Office, Saint Ouen, Paris

We consider an acceptable but rising level of risk, which should come out successfully, but this is not an easy market. LTV is nudging 60%, with valuation risk on the downside. We detail below why one RECI exposure to Paris has seen a writedown. Management has confidence there is no read-across to this senior-loan, noting an active engagement with the sponsor, which is likely to see a further equity injection in due course and a positive lease event, which while modest for the whole development is a trophy tenant and at rates that more than support the valuation.

While the market has changed since 2020, when the loan was instigated, particularly driven by interest rates, we believe at the time of the opening of this position, conservative valuations were already being put forward. This development at Saint Ouen is almost fully built. The sponsor is PE, and interest is currently being paid. Once tenants are in place, a refinance event can take place. In our view, this is one position to watch closely, but is not of concern, currently.

Balto – Housebuilder portfolio

Effectively a low LTV company loan in a market sector that – as well as upside – has some intrinsic risks but is performing reasonably

We consider RECI's position to be enhanced by its understanding not only of the French market but also of developers. This is a loan to a developer company, rather than a position with a specific development, by Lone Star. The company loan was to finance the 2021 purchase of a French housebuilder. RECI financed 35% of the purchase price; so, even with recent headwinds in the sector globally, the collateral would be well underpinned.

Perseus – Hotels (Nice)

RECI well positioned in competition with other lenders, but LTV is high

Here, too, the deep understanding of the hotel developer market that RECI has gained in recent years, amid COVID-19 turbulence, must be seen as a competitive advantage. It should not be forgotten that there has been a strong tourist season across Europe and, indeed, globally in summer 2023. The exposure originally included two assets, but the Paris Pigalle asset has been sold recently. Construction is progressing well, to complete within a year. Upon completion, the asset could be sold or refinanced.

What happened in December 2023

Impairment on asset now 3.1% of NAV

Slide 18 of the December presentation gave more in-depth detail on the French exposure, which saw a writedown. As at end-December 2023, the gross value of the senior loan was £10.3m, with a recovery value expected at that level. This represents 3.1% of NAV. The facility was made to a prime Grade A office asset located to the east of central Paris and backed by two, credible, well financed sponsors. The investment thesis noted, at the time, there was a migration from central Paris to the much-lower rental outer region. The development was concluded on time and to budget.

Changes in working patterns post COVID-19 have seen slow take-up of non-central Paris office space. Sponsors, unusually, unwilling to put more equity in.

However, with the post-COVID-19 changes in working patterns, Paris has been slow to see a recovery of tenants returning to the office. This has resulted in a slower-than-expected lease up of the building, due to its location outside Paris's CBD, where occupier interest is by far the strongest. Additionally, the sponsors, unlike many others, have been unwilling to restructure the loan and inject further equity.

In the interim, Cheyne's valuation policy is to reflect the lower asset valuation based off a lower-than-originally-expected rent roll and lower capitalisation rates. This resulted in an unrealised 1.6p hit to NAV. Cheyne will continue to work actively with the borrower and a selected asset manager to expedite leasing the asset, to secure early repayment of the principal as well as all accrued interest. In managing this position, like in the case of previous problem accounts, it will seek to optimise returns rather than simply dispose of a problem quickly.

Hardman & Co comments on recent French property market trends

GDP growth below EU average but remaining positive

The French economy, at the macroeconomic growth level, has been performing better than most other large European economies, albeit below EU average. Scandinavian and central European economies recently recovered the best. French GDP grew 2.7% in 2022 and 1.0% 2023 (Statista). While the EU as a whole grew 3.6% and 0.7% in 2022 and 2023, respectively, the other main economy, Germany, registered growth of 1.8% in 2022 and negative 0.5% in 2023.

Parisian office market is of concern. Central Paris much stronger than Greater Parisian region

The Parisian office market not only is a bellwether for commercial real estate but is of particular significance to RECI, given its two large Paris office exposures. Knight Frank estimates 900,000 sq. m. of newly-developed office space will be delivered in 2024 in Greater Paris, a number it describes as very high and it estimates vacancy rates will reach an all-time high in Paris this year. It points to the narrower central Paris supply constraint, confirming trends we have noted in our commentary on RECI positions. Across Île-de-France or Greater Paris, Knight Frank estimates office vacancy at 8.2%, compared with 7.5% at end-2022. UK investors should bear in mind that, for more than two decades, Parisian office vacancy rates have been between 2ppts and 4ppts higher than London rates.

People are taking holidays

The hospitality market is the next significant one for RECI. In 2023, RevPAR growth across Europe averaged a substantial 20%, still part of the post-COVID-19 recovery. As of its January 2024 report, CBRE estimated "high single-digit" rise in 2024's RevPAR. "We expect hotel demand growth to outpace supply". Unsurprisingly, CBRE recommends "popular tourism locations that already offer prime hotel space". It is noteworthy that budget airlines are reporting strong absolute and growth rates of profitability.

Outlook

Paris exposure with impairment

The loss is unrealised and so is subject to change. We see a range of potential factors, which could drive revaluations, both up and down, with a bias to a potential recovery at some stage over the next two years, noting there remains a realistic risk of further impairment on this asset.

Potential upside from i) RECI's conservative approach to accounting, ii) unwind of discount, and iii) improving capitalisation rates. Cheyne now controls the asset.

The factors driving a potential reversal of the impairment include:

- As we noted in our note, *Marks taken in uncertainty, released thereafter*, RECI has a track record of conservative accounting, taking MTM hits in periods of uncertainty, only to be followed by subsequent releases.

- The current recovery is based off discounted future expectations, and as the discount unwinds over time, *ceteris paribus*, the nominal valuation rises.

- The asset valuation has been driven by the expected rent roll (see comment below) and the capitalisation rates. In our view, the current capitalisation rates being adopted across the market reflect both the interest rate environment and the challenging market conditions. While there may be expectations that interest rates are staying higher for longer, the balance of probabilities is that the next moves will be down. While it is possible for market uncertainty to rise, again the bias of probabilities is more to the downside.

- The asset is now controlled by Cheyne, which can thus optimise any leasing/sale process to its recovery, free from interference by the sponsor.

Uncertain factors include rent roll in very dynamic market, and early sale of the asset. The fact the sponsors would not put in more equity is indicative of their concern.

Uncertain factors that could see further impairments or write up include:

- Should Cheyne's efforts lead to an above-expected rent roll, the asset value may be increased and the impairment reversed. To date, only a modest element of the building has been let, too small an amount to have certainty on the final rent roll. It is also quite possible that, over time, the expected rent roll could be lower, incurring further impairments. As we noted above, the environment is both challenging and dynamic.

- We understand the option of selling the asset to repay principal and all accrued income is also under consideration. This may or may not be at the current valuation, but sale would help certainty.

- The quality of sponsors is supported by the completion of the development project on time and on budget. It appears that Cheyne picked professional partners who know how to complete developments, albeit, if disappointingly, they would not inject further equity. The fact the developer would not inject further equity is, in our view, indicative of the fact that they do not believe the ultimate realisable value will be materially above Cheyne's current valuation.

Read-across to other French exposure

Risks of other exposures very different to the impaired one by sector, counterparty

More details of the accounting policy can be seen on slide 29 of the December presentation. In considering the risk of contagion to other French exposures, the risks on each loan are very different from the Paris development and management appears confident that no impairments are required. Supporting this view, we note:

- RECI's French assets are generally senior loans in prime locations on relatively low LTVs. While this may not prevent all losses, it does act to limit losses in the event of default. We considered this in more detail in our notes, Why CRE equity worries should not apply to RECI (published August 2023) and Double tangible security (published June 2023).

- As across the whole portfolio, there is sector and counterparty diversity within the French exposures. We note the Paris and South Coast hospitality markets are robust, supporting RECI's hotel exposures. As with other markets, logistics has proved an above-average resilient subsector. We understand, with the residential development exposure, the developer is evolving its product offering (to a more bulk, institutional sale programme from individual, personal sales) and Cheyne has a record of very low loan-to-value/costs for such projects.

- We also note that the Paris exposure was unusual with two sponsors, one developer and one financial. Their unwillingness to support the project is unusual in Cheyne's experience, and we have detailed in previous notes how the management of problem accounts, with a proactive engagement by sponsors, has been helpful to RECI in terms of limiting losses. The way in which hotel losses were avoided through COVID-19 would be a prime example of this.

Largest exposures are long established

- The three largest exposures are all well established with the smaller two being originated in 2021 and the largest in 2019. This means that Cheyne is very familiar with the projects, how they have progressed and the quality of their counterparties. As a general rule, newer lending is higher risk than established exposures.

Detailed review likely

- Having taken an impairment on one prime Paris exposure, we believe the manager will have been especially diligent in considering other writedown risks and note its comment "*Cheyne continues to monitor all of its positions and remains confident in the overall quality of its portfolio*".

Re-focus on prime, central sites is main lesson learnt

Looking forward, we understand the primary lesson learnt from the writedown has been to further reinforce the focus on prime exposures in, for example, the heart of Paris rather than supporting lower-rent, high-quality developments in the suburbs. In our view, this is unlikely to have a material impact on RECI's growth. We note the Cheyene pipeline at end-2023 was £1.1bn. The main constraint for RECI, rather than lack of opportunities, appears to be a limited appetite for gearing and the shares trading on a discount limiting new equity issues.

German exposure

German exposure now *de minimis*. Potential for write-ups and writedowns, driven by same factors as France

As can be seen on page 14 of RECI's *December Investor presentation,* the German exposure is now *de minimis* (ca.1% of commitments and NAV). The rising rate environment, a traditionally highly leveraged sector, and difficulties in accessing financing as debt matured all combined to see a sharp reduction in transactions and asset value – for more, see, for example, the Boston Consulting Group review, *Real Estate in Crisis*, published October 2023. This situation was then intensified by the well-publicised, November 2023 collapse of Signa group (see Reuter's article *here*).

In considering the November writedown:

- As with France, the loss is unrealised. As we noted in our note, *Marks taken in uncertainty, released thereafter*, RECI has a track record of taking MTM hits in periods of uncertainty, only to be followed by subsequent releases.
- The writedown leaves a residual exposure of £2.5m on the Berlin asset. Management believes this is realistic, noting it was based off a 4Q'23 valuation. The key drivers of the valuation are similar to the French ones. In a very uncertain and dynamic market, which management expects to continue for at least a year, the actual rent outcome remains hard to predict (creating the potential for further writedowns), perhaps to a greater degree than in France. As a mezzanine position, there is greater sensitivity to macro drivers (up and down) than in a senior position. As with France, the probability of uplift from lower interest rates seeing better cap rates appears greater than the downside probability; and, again we note RECI's conservative accounting.

In considering RECI's other German exposure:

- Cheyne has not actively originated new loans in the region for several years.
- The remaining exposures are work-out situations, or expected to repay in the near term.
- The remaining exposures are mixed-use.
- The exposure written down in November was a legacy mezzanine finance exposure. Across all geographies, RECI, for some time, has been concentrating new lending on senior loans with its better downside protection.

Spain: purpose-built student accommodation

Purpose-built student accommodation in Spain has several supporting factors

RECI has exposure to this sector, although this is outside its top 10 holdings. RECI has a £16.9m commitment exposure via one development in Seville and one in Palmera. Were the two exposures to be aggregated the size of the commitment would be the fourteenth largest commitment across the group. Both positions are nearly fully drawn, the developments well advanced. Although, overall, Spanish demographics are challenging, with falling numbers of younger inhabitants, the student population in major cities in Spain is rising consistently. In Madrid, for example, it has risen by 1.5% p.a. over the past decade. Such accommodation has proven relatively resilient in recent years, facing fewer challenges than bellwethers such as office and retail. COVID-19 led to rent holidays but has not dented rents or demand subsequently. Rents may be seen as high relative to non-purpose-built accommodation but the mix across Europe is steadily shifting towards purpose-built. Potential resistance to rent increases does not affect a senior loan position such as that held by RECI.

Key takeaways from the December investor presentation

Consistent themes with previous presentations, including stability of dividend covered by net interest income, conservative leverage, opportunities from Cheyne team and robust mitigation against rising rate environment

The key takeaways from the December investor presentation were:

- Quarterly dividends delivered consistently since August 2011, with a stable annualised dividend of ca.7% of NAV.
- 34 positions in real estate loans and bonds, across a diverse range of sectors and geographies, with a weighted average LTV of 60.7%, providing significant defensive equity headroom and an average yield of 10.2%, offering an attractive buffer to risk-free rates.
- Conservative leverage with September net leverage 6.4%, as at 31 December 2023, versus a leverage limit of 40% of NAV. The use of non-recourse and limited-recourse, term, structured finance provides returns optimisation and financial flexibility on senior loans.
- Access to established real estate investment team at Cheyne, which manages ca.$5bn AUM, and its current pipeline of enhanced return investment opportunities. Cheyne's immediate pipeline of deals was £1.1bn (September £1.6bn) with a WA LTV of 59% and unlevered IRR of 12.5% (September 11.1%).
- Robust mitigation against rising interest rates with a high-yielding portfolio. The short weighted average life of 1.5 years (December 2023) ensures a rapid redeployment at higher rates.

For the quarter, it noted:

Portfolio

- Total NAV return for the quarter was -0.6% (9M'FY24: +4.1%). There were no defaults in the portfolio. During the quarter, one UK loan fully repaid, realising net proceeds of £9.4m, and providing headroom to invest in new deals at enhanced IRRs.

Cash

- Cash reserves remain targeted at between 5% to 10% of NAV. As at 31 December 2023, cash was £12.1m/3.7% of NAV (up to £23m in January 2024).

Dividend

- Dividends maintained at 3p per quarter, annualised 9.3% yield, based on share price, as at 31 December 2023. The dividends are predominantly covered by net interest income.

Opportunities

- The present macroeconomic backdrop is set to continue through 2024, resulting in further constraints in bank lending and alternative sources of capital. The opportunity to provide senior loans at low-risk points, for higher margins, is increasingly evident. The company expects to deploy its currently available cash resources to its near-term commitments and towards a compelling emerging opportunity set in senior loans.

Risk review shows just 3.9% of portfolio in higher risk categories

- RECI provided (slide 17) a detailed review of its portfolio by its four risk ratings. The highest risk "Defaulted. Possible loss to NAV" category represented 0.8% of NAV, the second highest "Defaulted. No losses to NAV expected" was 3.1%, while "Performing. Watchlist for potential underperformance" was 13.3%.

RECI's top 10 exposures (January 2024)

Top 10 position by commitment

Asset type	Commitment (£m)	Current % NAV	Entry NAV (%)	Loan	Sector	County
Development	82.3	12	48	Senior	Mixed-use	UK
Development	45.2	6	58	Senior	Student accomm.	UK
Development	32.7	4	67	Senior	Residential	UK
Value add/transitional	30.9	9	58	Senior	Office	France
Development	22.4	5	49	Senior	Residential	Spain
Development	20.6	6	36	Senior	Housebuilder	France
Development	20.4	4	65	Senior	Hotel	Finland
Development	19.9	4	80	Senior	Hotel	France
Core+	19.7	5	60	Senior	Assisted living	UK
Core+	19.1	5	67	Senior	Hotels	UK

Source: RECI January 2024 Factsheet, Hardman & Co Research

Real estate exposure

The top 10 assets now total 60%, of total commitments; not a dramatic move but indicative of slightly greater concentration. The top single position has risen from 11% to 12% of NAV, as of end-December. It remains the case that the whole portfolio exposure to the UK remains high (58%), with France the next greatest (25%). Development positions dominate (72% commitments). All top 10 remain senior loans, and the counterparts are strong entities.

1: Max II – UK mixed-use development

Long track record with sponsor, portfolio with positions maturing and being refreshed, competitive advantage and value-add to sponsor

RECI has a long track record with this sponsor. There is a combination of yielding asset and development asset. We understand that there is a 60% LTV cap, with a series of deals being financed, and then maturing within the wrapper. Each new advance in the position is taken on its merit. A good amount is development land.

2: Fusion BXT – London student accommodation

This commitment was taken in November 2022, and so is priced post the worst of the market turbulence. There is a potential for student numbers from the EU remaining somewhat subdued post Brexit, but, for London, the overarching issue is the lack of supply and indeed the lack of supply of rental property in general, which has a positive knock-on for purpose-built student accommodation. Being a London asset, we consider the potential over-supply risk to be more than acceptable.

3: Fulton – London (Wembley) residential-led, mixed-use development

Again, balance of risk/reward/competition, much assisted by being strong project and sponsor well known to RECI

We consider RECI's position to be significantly enhanced, as it benefits from a positive track record with this sponsor. This is a residential-led, mixed-use development in Wembley, northwest London. Clearly, footfall has slowed this past year and the risks of this asset have risen. However, although footfall across markets in the UK is down, interest rates appear to have peaked, The Fulton development is selling well, we understand, and, on top of private sales, there is a current pre-selling phase of social housing to Brent Council. The developer, therefore, holds in escrow a useful quantum of deposits – a figure that is growing. This is a successful development as of time of writing, early 2024, and looks well-set.

4: Colisée – Office, Saint Ouen, Paris

We reviewed this exposure above.

5: Sabina – Spanish villas

Much of the sales risk has already been removed. This is a further phase, and the majority of the villas are pre-sold to high-net-worth individuals.

6: Balto – French housebuilder portfolio

We reviewed this exposure above.

7: Airport Hotel – Finland (Helsinki) hotel

LTV is perhaps surprisingly high, but RECI has high expertise and a very good track record in hotels – so is justified in backing its judgment

RECI has a deep understanding of the hotel developer market, and exited pre-COVID-19 positions with poise, after becoming more involved in the progress of the relevant projects during the COVID-19 turbulence. This stands RECI in good stead to assess risk. Here, the position is with a large, experienced contractor, retained under a fixed-price contract. The development is progressing on schedule, with expected completion in a short number of months.

8: Perseus – French hotels (Paris and Nice)

We reviewed this exposure above.

9: RS Kensington – Luxury assisted senior living, London

High-quality project in an under-served market

This is a Core+ exposure, a high-quality project in Kensington, London. The capital advanced was deployed in the acquisition of a 190-unit complex with facilities. This appears to be a straightforward position, with a granular exit, not reliant on other investors' capital to exit.

10: Champneys – UK hotel, yielding asset

RECI's strong track record with hotels and the macroeconomic situation both serve to strongly mitigate risks on this position. This is a new top 10 position, which features due to the disposal of the London, Hoxton office position. This is a senior loan, on 67% LTV. Across the UK and Europe as a whole, demand for hotel accommodation has been strong and supply has been held back by COVID-19.

Hoxton London office, let to WeWork, fully repaid

Since the last report, the loan on the Hoxton London office, fully let to WeWork on a long lease, has been repaid. Cheyne has again proved proactive and successful in restructuring problem accounts in the past.

Valuation

Absolute

Current NAV likely to be on conservative side

We have, in previous reports, considered how the NAV is assessed (see pages 23-24 of our initiation report, *7%+ yield from well-secured property debt portfolio,* published on 28 August 2019). The critical issues are how conservative the culture of the organisation is, and the independent checks and controls that are in place to review the process. As we noted in that report, RECI's approach to both issues appears to be in line with best practice.

Yield

12p annual dividend expected

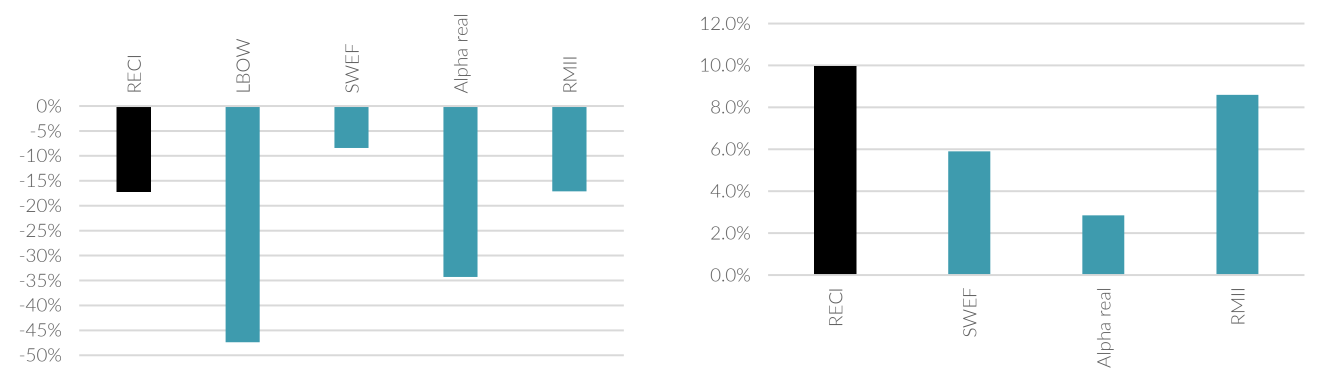
Through the COVID-19 crisis, when RECI took large, early MTM hits in 2020, and then steadily released them throughout the rest of the year, it maintained a consistent 3p quarterly dividend. The yield was covered largely by stable monthly interest income, and the bond MTM saw capital gains/losses feeding through to NAV noise. With the recent market recession uncertainty and the hiatus in the gilt and bond markets following the UK mini-budget, we saw the same happening, and, again, RECI followed the same, consistent policy: a stable 3p quarterly dividend. The trust appears very committed to this dividend, which is covered largely by interest income, and the noise from MTM losses and gains will reduce with a smaller bond portfolio. The current yield is 10%, and a 12p annual dividend is expected.

Relative

NAV rating and dividend yield among highest in close peer group

Comparisons of RECI with a close and broad peer group are given in the charts below. RECI's NAV rating is among the highest in the close peer group. Having returned to trade at a premium after the pandemic, the recent market uncertainty has, once again, meant that RECI is now trading at a discount. The dividend yield is the among the highest of RECI's closest peers (LBOW in wind-down). For investors who view the risk controls and procedures in RECI as robust, such a valuation appears anomalous. We have removed GABI from the comparison, given its proposed combination with GCP Infrastructure Investments Limited.

Premium/discount to NAV (LHS, %), and dividend yield for RECI and selected peers (RHS, %)



Source: Latest factsheets, priced at close at 27 February 2024, Hardman & Co Research

Financials

Profit and loss

Year-end Mar (£m)	2017	2018	2019	2020	2021	2022	2023	2024E	2025E
Interest income bonds	2.6	5.4	6.9	11.5	12.9	3.2	5.0	2.2	0.5
Interest income loans	12.5	12.8	15.2	14.9	14.1	23.7	26.7	35.9	41.7
Other interest income	0.2	0.2	0.2	0.1	0.0	0.0	0.2	0.0	0.0
Interest income	**15.3**	**18.4**	**22.3**	**26.4**	**27.0**	**27.0**	**31.9**	**38.0**	**42.2**
Net (losses)/gains on investments	4.6	2.8	(0.1)	(35.9)	18.2	5.4	(1.3)	-	5.0
Net losses on options	(2.4)	(0.9)	-	-	-	-	-	-	-
Net gains on foreign exchange instruments	(1.8)	0.2	3.1	-	0.1	0.0	0.0	-	-
Total net gains on fin. assets at FV through P&L	0.5	2.2	3.0	(36.8)	18.3	5.4	(1.3)	-	5.0
Operating income	**15.7**	**20.6**	**25.3**	**(10.4)**	**45.3**	**32.4**	**30.7**	**38.0**	**47.2**
Management fee	(2.0)	(2.6)	(3.0)	(4.1)	(4.3)	(4.4)	(4.3)	(4.2)	(4.2)
Performance fee	(0.1)	(0.3)	(0.7)	1.0	-	-	-	-	-
Other operating expenses	(1.1)	(0.8)	(1.1)	(2.4)	(1.6)	(1.5)	(1.8)	(2.0)	(2.1)
Operating expenses	(3.2)	(3.7)	(4.8)	(5.6)	(5.8)	(5.8)	(6.1)	(6.2)	(6.3)
Profit before finance costs	**12.5**	**16.8**	**20.4**	**(15.9)**	**39.5**	**26.5**	**24.5**	**31.8**	**40.9**
Finance costs	(3.4)	(1.9)	(1.2)	(1.5)	(2.2)	(2.0)	(4.0)	(5.0)	(5.0)
Net profit	**9.1**	**14.9**	**19.2**	**(17.4)**	**37.2**	**24.6**	**20.6**	**26.8**	**35.9**

Note: classification bonds and loans restated in 2021, Source: RECI Report and Accounts, Hardman & Co Research

Hardman & Co adjusted profit & loss

Year-end Mar (£m)	2017	2018	2019	2020	2021	2022	2023	2024E	2025E
Statutory profit	9.1	14.9	19.2	(17.4)	37.2	24.6	20.6	26.8	35.9
Capital gains & FX movements	0.5	2.2	3.0	(36.8)	18.3	5.4	(1.3)	-	5.0
Profit excl. capital gains & FX	**8.6**	**12.8**	**16.3**	**19.4**	**18.9**	**19.2**	**21.8**	**26.8**	**30.9**
Adjustment to performance fee	0.1	0.3	0.1	(0.3)	0.9	1.0	0.5	(0.5)	(1.3)
Adjusted profit	**8.7**	**13.1**	**16.3**	**19.0**	**19.9**	**20.2**	**22.3**	**26.3**	**29.6**
Cost of dividend	(8.4)	(13.7)	(17.6)	(25.1)	(27.5)	(27.5)	(27.5)	(27.5)	(27.3)
Statutory cover	1.1	1.1	1.1	(0.7)	1.4	0.9	1.3	1.3	1.3
– excluding capital gains cover	1.0	0.9	0.9	0.8	0.7	0.7	1.1	1.1	1.1

Source: RECI Report and Accounts, Hardman & Co Research

Balance sheet

@ 31 Mar (£m)	2017	2018	2019	2020	2021	2022	2023	2024E	2025E
Bonds	49.8	97.3	163.1	237.6	254.3	98.5	49.2	15.0	0.0
Loans	109.3	148.1	139.4	137.6	136.1	295.9	351.5	380.7	470.7
Financial assets at FV through P&L	**159.0**	**245.4**	**302.5**	**375.2**	**390.4**	**394.3**	**400.7**	**395.7**	**470.7**
Cash and cash equivalents	24.9	7.2	38.6	27.0	21.2	47.4	14.1	-3.8	0.2
Cash collateral at broker	0.0	2.4	1.4	25.0	0.9	5.2	2.4	2.4	2.4
Derivatives	0.9	0.2	0.7	0.0	2.3	0.0	1.8	1.8	1.8
Other assets	4.4	4.9	12.0	14.6	11.4	0.0	0.0	0.0	0.0
Receivables for investments sold	0.0	48.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total current assets	30.2	62.8	52.7	66.6	35.8	52.6	18.2	0.4	4.4
Total assets	**189.3**	**308.2**	**355.2**	**441.8**	**426.2**	**447.0**	**419.0**	**396.2**	**475.2**
Current liabilities									
Derivatives	0.0	0.0	0.0	6.2	0.0	1.1	0.0	0.0	0.0
Financing	0.0	78.3	100.1	97.0	77.8	100.4	80.2	60.0	35.0
Cash collateral due to broker	0.4	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Preference shares	41.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other liabilities	2.7	1.3	1.7	1.5	1.5	1.6	1.9	1.9	1.9
Total liabilities	45.0	79.6	102.0	104.6	79.4	103.0	82.0	61.9	36.9
Net assets	**144.3**	**228.5**	**253.2**	**337.2**	**346.9**	**343.9**	**337.0**	**334.3**	**438.3**
No shares (m)	88.4	139.4	153.3	229.3	229.3	229.3	229.3	227.7	292.7
NAV per share (p)	**163.2**	**164.0**	**165.1**	**147.0**	**151.3**	**150.0**	**146.9**	**146.8**	**149.7**

Source: RECI Report and Accounts, Hardman & Co Research

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